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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE, INC.,
Petitioner,

v.

COUNCIL OF THE CITY OF NEW ORLEANS, et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITY COMMISSION OF THE STATE OF OREGON AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Does a State or local regulatory agency have jurisdiction to find a utility subsidiary of a multistate holding company imprudent in failing to avail itself of the opportunity to reduce its financial and operational risks and protect its ratepayers by diversifying its power supply?

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INTEREST OF THE AMICI CURIAE*

This case is critically important to California and Oregon. We are responsible for ensuring that only reasonable expenses are included in retail rates charged to ratepayers in California and Oregon. In discharging our regulatory responsibilities, we determine whether the practices of a utility in maintaining its power supply are prudent before allowing costs to be recovered in retail rates. Factors considered in this process include the reasonableness of the costs in light of other alternatives and the reasonableness of the utility in managing its power supply. This type of review is a traditional function of retail ratemaking, based on the

* All parties have consented to the filing of this brief and letters of consent have been filed with the Clerk.

well-established principle that costs may be passed on to ratepayers only to the extent they have been prudently incurred. *Missouri ex. rel. Southwestern Bell Tel. Co. v. Public Service Com'n.*, 262 U.S. 276 (1923).

In the aftermath of *Nantahala Power & Light Co. v. Thornburg ("Nantahala")*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore ("Mississippi Power & Light")*, 487 U.S. 354 (1988), States have faced federal court challenges by utilities regarding state authority to review management choices in administrating power contracts and in pursuing power supply options. Based on the language in *Mississippi Power & Light* and *Nantahala*, utilities have asserted that wholesale power costs are "trapped" whenever a state commission disallows such costs from retail rates, even when the Federal Energy Regulatory Commission ("FERC") has not allocated power among affiliates.[1] Petitioner seeks a ruling in this case that FERC has jurisdiction to review utility procurement practices which are *separate and apart* from a FERC order allocating power and costs among affiliates. Such a ruling may result in claims that States lack authority to review procurement practices of their retail utilities, even nonaffiliated utilities. Such claims, if upheld, could effectively exempt resource planning by utilities from any regulatory review.

The decision of the United States Court of Appeals for the Fifth Circuit in *New Orleans Public Service, Inc. v. Council of the City of New Orleans*, 911 F.2d 993 (1990), correctly found that Congress did not vest FERC with exclusive jurisdiction over all possible prudence issues associated with choices made by a retail utility which is affiliated with a multistate holding company. Where, as in the present case, state review focuses on decisions made independently by the subsidiary utility, federal jurisdiction does not extend to preempt the state prudence inquiry.

State or local regulatory review of the purchasing practices of utilities ensures that they procure reliable, diversified, least cost

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[1] *See, e.g., San Diego Gas & Electric Co. v. The Public Utilities Commission of the State of California*, No. 89-3551-MHP, U.S. District Court, Northern Dist. of Calif., *complaint pending*.

sources of power. Utilities, whether affiliated with multistate systems or not, may rely on reversal of the Fifth Circuit's opinion to assert that States have no role in reviewing the prudence of utility procurement practices, once FERC has established a wholesale rate or allocation. Such a result would be directly contrary to this Court's rejection of Petitioner's sweeping facial preemption claim in *New Orleans Public Service, Inc. v. Council of City of New Orleans ("NOPSI III")*, 491 U.S. 350, 367 (1989). A clear delineation of the extent of state authority is necessary to affirm the obligation of utilities to continue to manage power supply in a reasonable fashion even when FERC has allocated costs of a power source to subsidiaries of a multistate holding company. We submit this brief as *amici curiae* to urge the Court to affirm the decision of the Fifth Circuit.

SUMMARY OF ARGUMENT

This case presents the issue of whether a state or local regulatory agency has jurisdiction to find a utility subsidiary of a multistate holding company imprudent in failing to avail itself of the opportunity to reduce its financial and operational risks and protect its ratepayers by diversifying its power supply. Under the rule established by *Mississippi Power & Light* and *Nantahala*, States cannot disturb the allocation of power FERC has mandated. States are also prohibited from interfering with FERC's authority to set wholesale rates or second-guessing FERC's approval of the decision of a holding company and its affiliates to participate in the construction of a generating plant. This said, *Mississippi Power & Light* and *Nantahala* do not abrogate existing state jurisdiction to review other issues of prudence affecting retail rates, independent of transactions among affiliates. This Court has stated emphatically that examining whether a utility has prudently diversified its supply portfolio and imposing costs of imprudent decisions on utility shareholders is not "directly or *even indirectly* foreclosed by the federal statute, the regulations implementing it, or the case law applying it." *NOPSI III, supra*, 491 U.S. at 367 (emphasis added). In *NOPSI III*, this Court found, under the same essential facts as in this case, that the Council of the City of New Orleans ("Council") did not directly or indi-

rectly attack the FERC-set allocation or rate, or examine the prudence of New Orleans Public Service, Inc.'s ("NOPSI") agreement to participate in the Grand Gulf nuclear power plant in the first place. *Id.*

The Fifth Circuit's opinion in no way conflicts with *Mississippi Power & Light* and *Nantahala*. In those decisions, the States asserted jurisdiction over issues which either were or could have been raised before FERC. The prudence inquiries held preempted in these cases involved transactions *among* affiliates. In the present proceeding, by contrast, the Council reviewed decisions which NOPSI made *independently* of its affiliates. Moreover, NOPSI was not legally prohibited by the terms of the system agreement from reselling part of the nuclear power allocated to it by FERC to other utilities.

ARGUMENT

A. THE COUNCIL'S INQUIRY IS DISTINGUISHABLE FROM THE INQUIRIES HELD PREEMPTED IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*.

1. FERC lacks jurisdiction to decide whether NOPSI prudently managed its power supply.

Congress gave FERC jurisdiction over sales of wholesale power but reserved to the States the right to review the retail activities of electric utilities. *Federal Power Com'n v. Southern Cal. Edison Co.*, 376 U.S. 205, 214 (1964). This reservation of authority is set forth in the statute itself. FERC's jurisdiction "extends only to those matters which are not subject to regulation by the States." (16 U.S.C. § 824(b)(1).) Traditional state responsibilities include review of the reasonableness of utility procurement practices including diversification of power supply.

Unlike the questions at issue in *Mississippi Power & Light*, FERC cannot undertake the inquiry which was the basis of the Council's disallowance. The Council addressed NOPSI's failure to reduce its risks (and rates) by pursuing off-system sales. No wholesale off-system sales were in fact made. FERC's jurisdiction to review the prudence of the wholesale purchaser does not extend

to review issues of procurement for a retail utility. FERC's allocation proceeding related only to transactions *among* affiliates.

In *Mississippi Power & Light*, this Court found that FERC had jurisdiction over transactions among affiliates regarding the Grand Gulf nuclear power plant. In contrast, the Council's disallowance was based on NOPSI's *independent* failure to act to diversify its power supply. The Council accepted the costs allocated to NOPSI by FERC and assumed in its proceeding that NOPSI was obligated to pay these costs. The Council reviewed what options were available to NOPSI in the context of its independent role as a retail utility responsible for ensuring the least-expensive, reliable supply of power for its ratepayers. The Council found that NOPSI failed to pursue selling some of the Grand Gulf power to other utilities and replacing it with lower cost coal-fired power. These options were *unrelated* to the system agreement reviewed by FERC. The Council then fashioned its disallowance based on the savings NOPSI could have gained for its ratepayers had it pursued the very off-system sales option it had proposed.

The Solicitor General argues that FERC has jurisdiction over all possible prudence issues related to the allocation of the Grand Gulf nuclear power plant, including whether NOPSI should have sold a portion of its anticipated allotment of nuclear power to other utilities. Both this Court and the Court of Appeals for the Fifth Circuit, however, have recognized that the issue that the Council reviewed is separate and distinct from those issues which the Supreme Court found in *Mississippi Power & Light* could have been raised but were not before FERC. *NOPSI III, supra,* 491 U.S. at 367; *New Orleans Public Service, Inc. v. Council of the City of New Orleans, supra,* 911 F.2d at 993. In short, the issue of whether a retail utility has properly managed its power supply is both logically and legally distinct from whether a subsidiary utility of a multistate holding company has fulfilled its system responsibilities.

In *NOPSI III*, this Court stated that nothing in federal law preempts the action taken by the Council in imposing the costs of imprudent management on NOPSI's shareholders. The Fifth Circuit relied heavily on *NOPSI III* in declining to find, without a firmer statement of Congressional intent, that the matter ad-

dressed by the Council had been committed to FERC's exclusive jurisdiction. *New Orleans Public Service, Inc. v. Council of New Orleans, supra*, 911 F.2d at 1002. Where FERC has no authority to address particular issues, such as the failure of a utility to diversify its power supply by making off-system sales to unrelated entities and replacing it with lower-priced coal-fired power, the jurisdiction is reserved to the States. *Id.*

2. No potential for overlapping reviews and conflicting orders exists where state and federal authorities address different issues.

The FERC's assertion of authority over prudence-related issues arising from transactions *among* affiliates in an integrated system is logical. For the State to focus on choices made by the wholesale buyer in setting retail rates, a distinct "buyer" and a distinct "seller" must exist. Otherwise, the State might in its review duplicate issues raised in the FERC's review of transactions among affiliates. Such duplication might occur in power pooling arrangements involving affiliated companies, in which the distinction between the wholesaler as buyer and the wholesaler as seller may become blurred. Thus, an affiliated utility could be at one time a "buyer" and at another time a "seller". In such circumstances, where there is a single entity, simultaneously serving as wholesaler and retailer, orders from federal and state authorities may conflict and costs become trapped. *Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n.*, 650 F.Supp. 659, 665-66 (M.D.Pa. 1986), *aff'd.*, 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 109 S.Ct. 365 (1988). Furthermore, in the multistate holding company situation, "[I]t is entirely reasonable to think that the fairness of rates and contracts relating to *joint ventures among* affiliated companies cannot be separated from an inquiry into the prudence of each affiliate's participation." *Mississippi Power & Light, supra*, 487 U.S. at 382 (emphasis added), concurring opinion of Justice Scalia.

The need for a neutral federal forum disappears once transactions among affiliates are no longer involved. Where affiliates act as stand-alone utilities, the potential for duplication of review disappears. FERC approval of allocation of power and rates for subsidiaries of a multistate holding company sharing a power

source or of the agreement to participate in construction does not absolve the purchasing utility from the responsibility to manage its share of the resulting power supply in a prudent manner.

The Council did not review the prudence of transactions among affiliates. Instead, the Council focused on NOPSI's available choices as an independent utility to purchase and sell power. Under these circumstances, where the state and federal authorities address different issues, no potential for overlapping reviews and conflicting orders exists.

Moreover, unlike its regulatory counterparts in *Mississippi Power & Light* and *Nantahala*, the Council did *not* attempt to revise the FERC's allocation so as to shift costs to ratepayers of other States. Off-system sales of power by NOPSI in 1980 would not have affected either the wholesale rate or allocation set by FERC in 1985. Similarly, review of NOPSI's failure to pursue diversifying its power supply did not affect NOPSI's affiliates. The Council's disallowance impacted only the ratepayers and shareholders of NOPSI. As this Court has noted, if the State finds imprudence, the State may take the normal ratemaking step of making the shareholders rather than the ratepayers absorb the excessive costs. *NOPSI III, supra*, 491 U.S. at 367; *see also Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n., supra*, 837 F.2d at 609.

B. REVERSING THE FIFTH CIRCUIT AND FORECLOSING STATES FROM REVIEWING UTILITY POWER SUPPLY CHOICES WOULD CREATE A REGULATORY GAP.

This Court has stated that a State's review of the reasonableness of a utility's purchases of power would not be preempted ". . . if [the utility] had the legal right to refuse to buy that power." *Mississippi Power & Light, supra*, 487 U.S. at 374. In a situation where a utility has no choice, costs could be unfairly trapped if a State evaluated the reasonableness of the utility's actions. If the utility had a *choice* whether or not to purchase power (or to sell power off-system), however, the State may determine whether the utility exercised that choice prudently before passing through the costs in retail rates.

In the instant case, the system agreement reviewed by FERC did not prohibit NOPSI from diversifying its power supply. Indeed, the Council found, based on what one appellate court has found to be a "preponderance" of the evidence, *Alliance for Affordable Energy Inc. v. Council of New Orleans*, 578 S.2d 941, 964 (La.Ct. App. 1991), that NOPSI had the ability to sell part of its Grand Gulf nuclear power off-system and replace it with lower-cost coal, but failed to avail itself of this opportunity. NOPSI had a choice and the Council concluded that it failed to choose prudently.

To reverse the Fifth Circuit and prohibit States from reviewing procurement practices where a utility has the ability to pursue various options would result in a regulatory gap. This result cannot be squared with the definitive language this Court used in *NOPSI III* upholding the ability of local governments to review utility management of power supply, even where the utility is a subsidiary in a multistate holding company. Furthermore, reversal of the Fifth Circuit could be used by *any* utility, including nonaffiliated utilities, as a shield to prevent state review of utility power procurement decisions. By contrast, affirming the Fifth Circuit's decision will underscore utility responsibility to manage wisely where choices are available.

To fulfill its responsibility to ratepayers, utility management must be held accountable for failure to take advantage of opportunities to reduce retail rates. FERC approval of wholesale rates and allocations does not eradicate utility responsibility to procure reliable, least-cost sources of power and to reduce financial and operational risks associated with excessive reliance on a particular technology or fuel. State review of utility choices in these areas does not intrude upon FERC's exclusive jurisdiction over prudence issues arising from transactions among affiliates.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be affirmed.

Respectfully submitted,

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